# DEPARTMENT OF TAXATION
# 2018 Fiscal Impact Statement

**1. Patron** James W. Morefield

**2. Bill Number** HB 222

**House of Origin:**
X **Introduced**
____ **Substitute**
____ **Engrossed**

**Second House:**
____ **In Committee**
____ **Substitute**
____ **Enrolled**

**3. Committee** House Finance

**4. Title** Income Tax; Corporate Apportionment for Certain Companies & Individual Subtraction for Their Employees

**5. Summary/Purpose:**

This bill would allow certain eligible companies operating in qualified localities to apportion Virginia taxable income using modified apportionment factors. This bill would allow employees of such companies an individual income tax subtraction. The Virginia localities in which eligible companies would generally be required to operate are: (i) the Counties of Bland, Buchanan, Dickenson, Lee, Russell, Scott, Smyth, Tazewell, or Wise, or the Cities of Bristol and Norton; (ii) the Counties of Grayson, Henry, Halifax, or Pittsylvania, or the Cities of Danville, Galax, or Martinsville; or (iii) the City of Petersburg.

This bill would require eligible companies to remit to the Department an applicable estimated tax. The applicable estimated tax would include:

- The company's regular income tax liability without the benefit of any of the modified apportionment factors allowed under this bill and

- The amount that such company would have been required to withhold if the eligible company's employees were not eligible to claim a subtraction under this bill.

The Governor would then be permitted to award funds from the Commonwealth's Development Opportunity Fund as grants or loans to pay all or a portion of such company's applicable estimated tax.

The effective date of this bill is not specified.

**6. Budget amendment necessary:** Yes.

**7. Fiscal Impact Estimates are:** Not available. (See Line 8.)

**8. Fiscal implications:**

<u>Administrative Costs</u>

The Department of Taxation ("the Department") has not assigned any administrative costs to this bill because the changes required by a single bill such as this can be implemented as part of the annual changes to our systems and forms. As stand-alone legislation, the Department considers implementation of this bill as “routine,” and does not require additional funding.

The Department will provide specific administrative costs on any legislation that is not "routine." Additionally, the Department will review all state tax legislation likely to be enacted prior to the passage by each house. If the aggregate number of routine bills likely to pass either house is unusually large, it is possible that additional resources will be required. If so, the Department will identify the costs at that time.

The Department of Accounts ("DOA") considers implementation of this bill as "routine," and does not require additional funding.

The Virginia Economic Development Partnership ("VEDP") states that, at this time, the financial impact of the bill is undetermined.

Revenue Impact

This bill would have an unknown General Fund revenue impact beginning in Fiscal Year 2019. The extent to which companies would qualify to use the modified apportionment factors that would be provided in this bill, and elect to do so, is unknown. In addition, the extent to which such companies' employees would claim the subtraction that would be provided in this bill is unknown.

This bill also would require eligible companies to remit to the Department an applicable estimated tax. The applicable estimated tax would include (i) the company's regular income tax liability without the benefit of any of the modified apportionment factors that would be provided under this bill and (ii) the amount that such company would have been required to withhold if the eligible company's employees were not eligible to claim a subtraction under this bill. The Governor would then be permitted to award funds from the Commonwealth's Development Opportunity Fund as grants or loans to pay all or a portion of such company's applicable estimated tax. The impact of this provision is unknown.

**9. Specific agency or political subdivisions affected:**

Department of Taxation
Department of Accounts
Virginia Economic Development Partnership

**10. Technical amendment necessary:** Yes.

As currently drafted, this bill appears to require otherwise eligible employers that already have property and payroll located in Virginia to do two tax calculations, pay the higher amount, and then request grant funding or a loan for the total amount due. It is unclear whether this same process would also apply to companies that do not currently have property or payroll in Virginia.

It is also uncertain how this bill would treat withholding payments made by such employers. The bill states that the wages of qualifying employees would not be subject to the withholding requirement, but also requires certain employers to pay such wages over to the state before requesting reimbursement in the form of a loan or grant payment.

The grant and loan portion of this bill is unclear because it appears to apply to the full amount of tax due, not just the incremental portion that is attributable to the law change. Effectively, this would allow a company to receive a grant or loan for the full amount of tax due, not just the tax attributable to the eligible localities.

Therefore, the Department suggests that this bill be amended to clarify these ambiguities.

In addition, the Department suggests the following amendments:

Page 10, Line 591, After may subtract
Strike: the value of

Page 11, Line 647, After may subtract
Strike: the value of

**11. Other comments:**

Virginia's Methods of Apportionment

*Statutory Method of Apportionment*

Virginia generally requires the Virginia taxable income of a multistate corporation to be apportioned to Virginia by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor, plus twice the sales factor, and the denominator of which is four. The property factor is a fraction that consists of the average value of the corporation's real and tangible personal property owned or rented and used in Virginia over the like property located everywhere. The payroll factor is a fraction, the numerator being the total amount of compensation paid or accrued within Virginia during the taxable year by a taxpayer, and the denominator being the total compensation paid or accrued everywhere during the taxable year. The sales factor is a fraction, the numerator of which is the total sales of the corporation in Virginia during the taxable year, and the denominator of which is the total sales of the corporation everywhere during the taxable year.

*Modified Method of Apportionment for Manufacturing Companies*

During the 2009 Session, the General Assembly enacted legislation (House Bill 2437 (2009 *Acts of Assembly*, Chapter 821)) that allows manufacturing companies to elect whether to apportion Virginia taxable income using the statutory method of apportionment or using a single sales factor method of apportionment. This modification was phased in as follows:

- For taxable years beginning on or after July 1, 2011, but before July 1, 2013, qualifying corporations could elect to use a triple-weighted sales factor;

- For taxable years beginning on or after July 1, 2013, but before July 1, 2014, qualifying corporations could elect to use a quadruple-weighted sales factor; and

- For taxable years beginning on or after July 1, 2014, and thereafter, qualifying corporations may elect to use the single sales factor method to apportion Virginia taxable income.

A manufacturing company that elects to use the modified method of apportionment will be subject to additional taxes if such manufacturing company's average annual number of full-time employees for the first three taxable years that it used the modified method of apportionment is less than 90 percent of its base year employment, or if the average wages of the manufacturing company's full-time employees, as certified by the manufacturing company, is not greater than the lower of the state or local average weekly wage for its industry. "Base year employment" is defined as the average number of full-time employees employed by the manufacturing company in Virginia in the taxable year that ended immediately prior to the first taxable year in which the manufacturing company used the modified method of apportionment for manufacturing companies.

*Modified Method of Apportionment for Retail Companies*

During the 2012 Session, the General Assembly enacted legislation (House Bill 154 and Senate Bill 49 (2012 *Acts of Assembly*, Chapters 86 and 666)) that requires certain retail companies to apportion Virginia taxable income using a single sales factor method of apportionment. This modification was phased in as follows:

- For taxable years beginning on or after July 1, 2012, but before July 1, 2014, such corporations were required to use a triple-weighted sales factor;

- For taxable years beginning on or after July 1, 2014, but before July 1, 2015, such corporations were required to use a quadruple-weighted sales factor; and

For taxable years beginning on or after July 1, 2015, and thereafter, such corporations are required to use the single sales factor method to apportion Virginia taxable income.

*Modified Method of Apportionment for Certain Enterprise Data Center Operations*

During the 2015 Session, the General Assembly enacted legislation (House Bill 2162 and Senate Bill 1142 (2015 *Acts of Assembly*, Chapters 237 and 92)) that requires a taxpayer with an enterprise data center operation to apportion Virginia taxable income using single factor apportionment based on sales if such taxpayer enters into a memorandum of understanding with the Virginia Economic Development Partnership on or after July 1, 2015, to make a new capital investment of at least $150 million in an enterprise data center in Virginia on or after July 1, 2015. The modified method of apportionment applies beginning with the taxable year for which the Virginia Economic Development Partnership provides a written certification to such taxpayer that the new capital investment has been completed. The modification is being phased in as follows:

- From July 1, 2016 until July 1, 2017, qualifying corporations are required to use a quadruple-weighted sales factor; and

- From July 1, 2017, and thereafter, qualifying corporations are required to use the single sales factor method to apportion Virginia taxable income.

*Modified Method of Apportionment for Specific Industries*

In addition to the modified methods of apportionment described above, Virginia requires a taxpayers in certain industries to apportion their Virginia taxable income using single factor apportionment. However, this form of single factor apportionment is not necessarily based upon sales but instead is based upon other criteria that reflect how income is earned in the particular industry. These industry-specific methods of apportionment include:

- **Motor carriers**. Motor carriers of property or passengers must apportion their income to Virginia by multiplying their Virginia taxable income by a fraction, the numerator of which is vehicle miles in-state and denominator of which is total vehicle miles everywhere.

- **Railway companies.** Railway companies apportion their income to Virginia by multiplying their Virginia taxable income by a fraction, the numerator of which is revenue car miles in Virginia and the denominator of which is total revenue car miles everywhere.

- **Financial Corporations**. Financial corporations apportion their income to Virginia by multiplying their Virginia taxable income by a fraction, the numerator of which is business in Virginia and the denominator of which is the total business. Business in Virginia is based on cost of performance in Virginia over cost of performance everywhere.

- **Construction Corporations**. Construction corporations electing to report income on the completed contract basis apportion their income to Virginia by multiplying their Virginia taxable income by a fraction, the numerator of which is business in Virginia and the denominator of which is total business.

*Alternative Method of Apportionment*

If any corporation believes that the statutorily prescribed method of apportionment has operated or will operate as to subject it to taxation on a greater portion of its Virginia taxable income than is reasonably attributable to business or sources within Virginia, then it may submit a statement of objections to the Department and detail an alternative method of apportionment that it believes to be proper under the circumstances. If the Department concludes that the statutorily prescribed method of apportionment is inapplicable or inequitable, then it shall redetermine the corporation's taxable income by another method that best assigns to Virginia the portion of the income reasonably attributable to business and sources within Virginia. The amount assigned through an alternative method of apportionment may never exceed the amount that would have been assigned using the statutorily prescribed method.

The Department will not grant permission to use an alternative method of apportionment unless it determines that (a) the statutorily prescribed method of apportionment is inapplicable because it produces an unconstitutional result under the taxpayer's particular facts and circumstances; or (b) the statutorily prescribed method of apportionment is inequitable because (i) it results in double taxation of the income, or a class of income, of the taxpayer; and (ii) the inequity is attributable to Virginia, rather than to the fact that some other state has a unique method of allocation and apportionment.

*Apportionment by Pass-Through Entities*

Virginia requires the Virginia taxable income of a multistate pass-through entity to be apportioned to Virginia by using the apportionment methods applicable to corporations. However, the effect of the pass-through entity's apportionment method may vary from one owner to another, depending on the entity types of the owners:

- Virginia resident individual owners are taxable on all of their pass-through entity income regardless of the pass-through entity's apportionment method;

- Nonresident individual owners must use the entity's Virginia apportioned income in determining his or her own Virginia nonresident percentage; and

- A corporate owner must include the pass-through entity's apportionment factors in determining its own apportionment percentage.

<u>Proposed Legislation</u>

*Modified Apportionment Factors for Eligible Companies*

This bill would permit an eligible company that operates a qualified locality to elect to modify the application of Virginia's statutory three-factor method of apportionment by:

- Reducing the numerator of the property factor by an amount equal to the value of its property acquired in any qualified localities on or after January 1, 2018; and

- Reducing the numerator of the payroll factor by an amount equal to any payroll attributable to jobs created on or after January 1, 2018, in any of such localities.

In addition to eligible companies using Virginia's statutory three-factor method of apportionment, this bill would also permit an eligible company using a single factor method of apportionment to modify its apportionment factor, as explained below:

- **Manufacturing Companies.** This bill would permit an eligible company that is a manufacturing company that has elected to apportion its income using single factor apportionment factor based up sales to reduce the numerator of such factor by an amount equal to the value of its sales in any qualified locality or qualified localities.

- **Retail Companies**. This bill would permit an eligible company that is a retail company required to apportion its income using single factor apportionment factor based up sales to reduce the numerator of such factor by an amount equal to the value of its sales in any qualified locality or qualified localities.

- **Taxpayers with Enterprise Data Center Operations.** This bill would permit an eligible company that is a taxpayer with enterprise data center operations required to apportion its income using single factor apportionment factor based up sales to reduce the numerator of such factor by an amount equal to the value of its sales in any qualified locality or qualified localities.

- **Motor Carriers**. This bill would permit an eligible company that is a motor carrier of property or passengers to modify its single factor apportionment factor based upon vehicle miles by reducing the numerator of such factor by an amount equal to its vehicle miles traveled in any qualified locality or qualified localities.

- **Railway Companies.** This bill would permit an eligible company that is a railway company to modify its single factor apportionment factor based upon revenue car miles by reducing the numerator of such factor by an amount equal to its revenue car miles traveled in any qualified locality or qualified localities.

- **Financial Corporations**. This bill would permit an eligible company that is a financial corporation to modify its single factor apportionment factor based upon business conducted in Virginia by reducing the numerator of such factor by an amount equal to its business within any qualified locality or qualified localities.

- **Construction Corporations**. This bill would permit an eligible company that is a construction corporation to modify its single factor apportionment factor based upon business conducted in Virginia by reducing the numerator of such factor by an amount equal to its business within any qualified locality or qualified localities.

This bill would also permit an eligible company conducting its entire business within Virginia to elect to apportion its income between qualified localities and other Virginia localities and utilize modified apportionment factors.

An eligible company would be permitted to apportion its income using this bill's modified apportionment factors for the taxable year in which it first becomes eligible and for the nine subsequent, consecutive taxable years, except for any year in which:

- The eligible company's total, cumulative new capital investment falls below the applicable initial threshold; or

- The number of new jobs created by the eligible company falls below the applicable initial threshold.

The Department would be permitted to deny any taxpayer status as an eligible company if it determines such taxpayer has engaged in a merger, acquisition, similar business combination, name change, change in business form, or other transaction the sole purpose of which is to obtain status as an eligible company.

*Individual Income Tax Subtraction for Employees of Eligible Companies*

An employee of an eligible company would be permitted an individual income tax subtraction for any compensation received from such company for the taxable year in which the eligible company first elects to use modified property and payroll factors and for nine subsequent, consecutive taxable years.

The bill would provide that an employer would not be required to withhold Virginia individual income tax from any payment of wages to an employee if there is in effect with respect to such payment a withholding exemption certificate furnished by the employee to the employer, certifying that the employee anticipates that he or she will be entitled to this subtraction. However, such employee and the eligible company would be permitted to agree to additional withholding.

*Requirements to Be Considered an Eligible Company*

To benefit from the provisions of this bill, the company would have to constitute an "eligible company." An "eligible company" would be defined as corporation or pass-through entity that:

- Does not have any existing property or payroll in Virginia as of January 1, 2018, and on or after January 1, 2018, but before January 1, 2029, either:

  - Spends at least $5 million on new capital investment in a qualified locality or qualified localities and creates at least 10 new jobs in a qualified locality or qualified localities or

  - Creates at least 50 new jobs in a qualified locality or qualified localities; or

- Has property or payroll in a qualified locality or qualified localities as of January 1, 2018, and on or after January 1, 2018, but before January 1, 2029, either:

  - Spends at least $5 million on new capital investment in a qualified locality or qualified localities and creates at least 10 new jobs in a qualified locality or qualified localities or

  - Creates at least 50 new jobs in a qualified locality or qualified localities.

Such eligible company would be required to remit to the Department the applicable estimated tax for each year in which it seeks to qualify as an eligible company. "Applicable estimated tax" would be defined as:

- An eligible company's tax liability for the taxable year calculated without the modified property and payroll factors allowed for eligible companies under this bill, and

- The amount that such company would have been required to withhold for the taxable year if each of the eligible company's employees were eligible to claim a subtraction under this bill.

"New job" would be defined as a permanent, full-time position of indefinite duration requiring a minimum of (i) 35 hours of an employee's time a week for the entire normal year of the eligible company's operations, which normal year shall consist of at least 48 weeks, or (ii) 1,680 hours per year.

"New capital investment" would be defined as real property acquired in a qualified locality or qualified localities on or after January 1, 2018, but before January 1, 2029, and any improvements to real property in a qualified locality or qualified localities on or after January 1, 2018, but before January 1, 2029.

*Localities in Which Eligible Companies Must Operate*

To benefit from the provisions of this bill, the eligible company would be required to operate in certain qualified localities. A "qualified locality" would be defined as:

- The Counties of Bland, Buchanan, Dickenson, Lee, Russell, Scott, Smyth, Tazewell, or Wise, or the Cities of Bristol and Norton;

- The Counties of Grayson, Henry, Halifax, or Pittsylvania, or the Cities of Danville, Galax, or Martinsville;

- The City of Petersburg; or

- A qualified development site.

A "qualified development site" would be defined as real property that is in a locality adjacent to a qualified locality and, before January 1, 2018, either:

- Was owned or partly owned by a qualified locality or an industrial development authority of which a qualified locality is a member, or

- Was owned or partly owned by a locality or industrial development authority, was leased to a private party, and was subject to a revenue-sharing agreement providing that a portion of the revenues from the lease would be distributed to a qualified locality.

This bill would provide that "qualified development site" does not include real property that is not owned by Virginia or a political subdivision thereof.

*Grants and Loans*

This bill would provide that funds would be awarded from the Commonwealth's Development Opportunity Fund by the Governor as grants or loans to any eligible company to pay all or a portion of such company's applicable estimated tax. Such grants or loans would not be required to satisfy certain criteria that normally apply to grants or loans made from the Fund. These criteria include job creation, private capital investment, and anticipated additional state tax revenue expected to accrue to the state and affected localities as a result of the capital investment and jobs created. Such grants or loans would also be exempted from certain other requirements normally applicable to grants or loans from the Fund.

This bill would authorize the following localities to give grants or loans to any eligible company:

- The Counties of Bland, Buchanan, Dickenson, Lee, Russell, Scott, Smyth, Tazewell, and Wise and the Cities of Bristol and Norton;

- The Counties of Grayson, Henry, Halifax, and Pittsylvania, and the Cities of Danville, Galax, and Martinsville; and

- The City of Petersburg.

This bill would allow an authority to award loans or grants to any eligible company to pay all or a portion of such company's applicable estimated tax.

This bill would require that the Department of Taxation promulgate guidelines implementing its provisions.

The effective date of this bill is not specified.

Similar Bills

**Senate Bill 883** is substantially similar to this bill.

cc : Secretary of Finance

Date: 1/29/2018 JJS
HB222F161